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FAIR REGULATION OF RAILROADS.

BY SAMUEL O. DUNN.

THAT the railroads of the United States always, in future, ought to be subjected to public control every one now agrees. As to what form this control ought to take widely varying opinions are held which are reflected in inconsistent policies of the State and national Governments. In some States the railroads almost run the Governments, although this is not true in as many States as it was a few years ago. Elsewhere the States almost run the railroads. A good many people, who hold otherwise very different views, concur in fearing that a satisfactory policy of regulation will not be worked out, but that Government regulation will lead to Government ownership. The experience of Europe is cited. Germany, Belgium, Italy, Austria, Switzerland, have gone from Government regulation to Government ownership. France, after long owning and operating one small road and exercising strict supervision over six large lines, recently decided to take over one of these big lines, the Western. But European experience, while instructive, is not conclusive. Special conditions in every case have caused public regulation to be succeeded there by public ownership. Our political and industrial history and institutions are different from those of European countries, and in this matter, as in some others, we may perhaps find it more expedient to be warned by their mistakes than to follow their example.

The problem of how the railroads shall be regulated probably will be advanced a long way toward solution when the question of who is to regulate them is better settled. This question, raised recently by a multitude of laws, is pending in novel forms in Federal courts all over the country. Whether exclusive Federal control be desirable or not, we cannot expect to get it, in view

of past decisions of the Supreme Court of the United States, without amendment of the Federal Constitution. We may reasonably hope, however, that the courts will hold that where State laws or regulations necessarily interfere with or nullify a Federal law or regulation the former must yield. Congress then, by setting a good example and by firmly limiting the activities of State legislatures and commissions, can foster a consistent railroad policy that will benefit both the carriers and the public. How badly such action by Congress is needed is perhaps best indicated by the fact that within the five years, 1904-08, inclusive, the State legislatures enacted no less than 800 provisions to regulate common carriers.

There is another phase of this question of who shall regulate the railroads. Shall it be done by the lawmakers directly or through commissions? The nation has an Interstate Commerce Commission whose powers were greatly enlarged by the Hepburn act of 1906. Eight States within the past six years have created new railroad commissions. Seven within the same time have increased the powers of their old commissions. Thirty-nine States now have railroad commissions. We have wisely concluded that so difficult and technical a subject should be dealt with by a small body of experts in practically continuous session. Unfortunately, the State legislatures, while abstractly indorsing this theory, cannot always be got to act conformably with it. During recent years, in all parts of the country, they have constantly interfered with work that they had previously delegated to the commissions. An extreme example was in Wisconsin, where, after the State railroad commission, one of the ablest bodies of the kind in the world, had decided after an exhaustive investigation that two and one-half cents was a reasonable passenger fare, the legislature, without any investigation at all and over the outspoken protests of the commissioners, passed a two-cent-fare law. If railroad commissions are to command the respect of railroads, shippers and public, if they are to perform their duties fairly, intelligently and beneficially, they and their work must be left as free from legislative interference as are the courts and their work.

The appointive commissions are usually far superior to the elective. Of the fifteen States that within six years have created new or remodelled their old commissions those of ten are ap-

pointed by the Governor and of five are elective. In one of these States, whose commission is appointive, the Governor named as commissioners a leading lawyer, a distinguished professor of economics in the State University and an expert statistician. In another of these States the people elected as two of the three commissioners a cowboy who had "killed his man" and who since his election has been arrested and fined for flourishing his gun, and a man who a short time before had bought a gold brick for \$10,000. In another State the people elected recently to the railroad commission a man whose only claim on their suffrages was that while a railroad brakeman he had lost both legs in a railroad accident. Cowboys, purchasers of gold bricks, and legless brakemen are not the kind of men that will solve the problem of fair regulation of railroads.

Regulation should relate, as already it generally does relate, to three phases of the railroad business: (1) operation; (2) rates; (3) finances.

Railroad managers have sometimes protested against interference by public authorities with the physical operation of the roads. Regulation of physical operation is perhaps more defensible than any other form. The first duty of common carriers is to provide ample and safe facilities of transportation. Where it is obviously to their selfish interest to do this they may be trusted to do it voluntarily. Regulations to punish people for not doing what they already are straining every nerve to do are futile or harmful. In this class belong the so-called "reciprocal demurrage" rules that were adopted in 1907 by the authorities of ten States. Business had outgrown facilities of transportation, despite herculean efforts by railroad managements. These ten States in their wisdom fixed penalties to be imposed on the roads for not furnishing the needed cars, which did not exist but which the railroads had ordered. By the time the cars were built traffic had slumped enormously, and from January to August, 1908, from 200,000 to 400,000 idle freight-cars stood on side-tracks. No wise legislature or commission required shippers to provide freight to load these idle cars.

Where it is not obviously to the interest of carriers to serve the public well, or they do not do so, it is a proper function of public regulation to compel them to do so. Public regulation has no more important duty than that of making railroad operation

safer. In the year ended June 30th, 1907—the latest year for which complete statistics of the Interstate Commerce Commission had been issued when this article was written—11,839 persons were killed and 111,016 were injured on American railroads. Only a small part of these casualties took place in train accidents. Of the deaths, 1,270, and of the injuries, 15,463, were due to collisions and derailments. Five thousand six hundred and ten persons, or forty-eight per cent. of the total number killed, met their deaths while unlawfully trespassing upon railroad property. The perilous grade crossing claimed 934 lives. A large part of the remaining accidents was due to violation of operating rules by employees. In order to get safe operation of railroads three classes must be subjected to stricter public regulation—railroad managements, railroad employees and the public. The Railroad Commission of Indiana has grasped this important fact and begun an intelligent and thorough campaign to reduce accidents. In its quarterly accident bulletins the Indiana Commission distinguishes between accidents for which the railroads are responsible and accidents for which they are not to blame. To reduce accidents due to employees it has asked the State legislature to make violation of the rules of the companies punishable by fine and imprisonment whether casualties result or not. This is the law in England. To reduce accidents due to trespassing upon railroad property it has asked the press of the State to co-operate with it in pointing out the danger of such trespassing and has urged the legislature to enact a law for the abatement of this evil. If it be more important that railroad operation and travel in the United States shall be made safe than that transportation shall be made cheap, the Railroad Commission of Indiana is a pioneer in the most important work that such a body can do.

There are other features of railroad operation that public regulation should improve for the convenience of the public. The late passenger train is a chronic nuisance. Everybody has been exasperated by it. In the stress of competition for business railroads frame passenger-train schedules that it is often impossible for their trains to “make”; and travellers are annoyed by missing connections and business and social engagements and being kept waiting at stations. The New York Public Service Commission, Second District, in 1907 found a passenger train on a certain road that did not reach destination on time a single day

in July or August. It found a train on another road that was not on time from October 20th to December 1st. On another road it found a train that was late every day in November. On still another road it found a train that was late every day in December. It took steps to stop that kind of thing. If a railroad cannot make its trains conform to the published time-tables it ought to be compelled to make the time-cards conform to the running time of the trains.

Public regulation of the physical properties and of the operation of railroads must be done with a reasonable regard for their earning power. The public cannot compel the roads to spend large sums to furnish safe and adequate transportation without letting them earn the money necessary to defray the expense involved and to pay a reasonable profit besides. It must choose whether it will have convenience, safe and adequate facilities of transportation or the cheapest possible transportation. It will cost immense sums of money to put all the railroads of this country in the shape that such railroads as the Pennsylvania, the Lake Shore and parts of the Chicago and Northwestern are in. They cannot sell the securities to raise this needed money unless it shall be reasonably certain that they will be allowed to charge rates that will enable them to earn enough to pay interest and substantial dividends on fair capitalizations.

The phase of railroad regulation that has received most attention in this country is regulation of rates. One principle has been very firmly established by legislation, decisions of the courts and public sentiment—that railroads, being quasi-public corporations, cannot legally or morally discriminate unfairly in their rates between individuals or localities. The establishment of this principle, after years of flagrant violation of it, has abolished the rebate and is abolishing the free pass. No other principle of rate regulation can be said to have been established and accepted as just and salutary by both railroads and regulating authorities.

The methods of rate regulation vary from State to State and even in the same State. (1) The legislatures sometimes fix schedules of maximum rates for all the traffic in the State. (2) In some States the railroad commissions initiate, on their own motion, schedules of maximum rates for part or all of the traffic. (3) The Interstate Commerce Commission and the commissions of a number of States can only fix rates after somebody has

complained and shown on formal hearing that existing rates are unreasonable. (4) In some States the commissions can only investigate rates and recommend changes. This substantially was true until two years ago of the Interstate Commerce Commission.

The third method seems to work best. Entire schedules made by legislatures or commissions repeatedly have been held unconstitutional by the Federal courts because the regulating authorities, in their zeal to get something done, did not ascertain by patient, thorough and intelligent investigations what would be just as between travellers, shippers and carriers, and in consequence fixed rates so low that, taken as a whole, they were confiscatory. In other cases legislatures and commissions have made schedules which were high enough perhaps to be not confiscatory, but were so low as to discourage railroad development and therefore to be inexpedient. From this cause railroad development is to-day practically at a standstill in Texas, which has yet over fifty counties without a railroad. The State railroad commission has hurt the State as much as it has the carriers.

The initiation of rates should be left in the hands of the numerous traffic managers of the railroads, who are in constant conference with shippers, who usually have good reason for doing all they can to promote industrial development and who have better means of informing themselves about the conditions and needs of the territory their lines serve than any legislature or commission. Power to change specific rates that are unjust or excessive should be given to commissions of experts to protect the public against the occasional unwisdom or unfairness of traffic managers.

The basis on which rates ought to be regulated has been much discussed recently. The Interstate Commerce Commission has asked Congress for authority and funds to make a valuation of the physical properties of railroads as a basis for fixing reasonable rates. In Michigan, Wisconsin, Minnesota, South Dakota, Washington, Texas and other States valuations have been made or are in progress. These valuations are usually estimates of the cost of reproduction of the physical properties in their present condition. It is assumed that the carrier should be permitted to earn only a "reasonable rate of interest" on the value of its physical property. One objection to valuations as bases for rate regulation is that they may be unfairly low. In Texas the State

Tax Board in 1907 placed a valuation upon the railroads of the State for taxation of \$419,381,404. In the same year the railroad commission placed a valuation upon them as a basis for rate regulation of only \$200,222,306, and argued that roads whose net earnings were eight to twelve per cent. of its valuations were prosperous. It would have been just as fair for it to have valued the properties at half the amount that it did and then argued that these roads were earning sixteen to twenty-four per cent.

Even if a general valuation of railroads based upon their cost of reproduction should be fairly made its use as a basis for adjusting rates over a wide area might work great hardships. A road running through a mountainous country, such as the Denver and Rio Grande, might cost more per mile to reproduce, is proportionately more expensive to operate, and has less traffic per mile than a road such as the Union Pacific which runs mainly through easy and productive country. If a physical valuation of the Union Pacific should convince the Interstate Commerce Commission that it is making too much money and its rates should be reduced, the Denver and Rio Grande would have to reduce its rates to compete with the Union Pacific even though its business already was not profitable. Similar examples could be cited from every section of the country.

A fair valuation of railroads would be based, not merely upon the cost of reproducing their physical properties, but also upon the density of their traffic, the relative costs of operating them, their strategic location—upon everything that legitimately tends to make them profitable and enters into their value as going concerns. The proposition to base railroad rates upon any theory of the cost of producing transportation is looked upon with disfavor by most economists and railroad executives, but rates based upon a valuation in which factors such as those just mentioned were considered much more equitable than rates based merely upon the value of the individual locomotives, cars, ties and fish-plates constituting the railroad's physical plant.

Whether fixed by traffic managers or regulating authorities, rates should be based mainly, not upon the value of the railroad, but upon the value of the service that the railroad renders. They should be "based upon what the traffic will bear"—and, also, they should not be based upon what the traffic will not bear. Dry-goods will bear a higher rate than coal; therefore, coal

should have a lower rate. Coal moving twenty miles will bear a higher rate per ton mile than coal moving one hundred miles; therefore, the rate per ton mile should not be as high for the longer as for the shorter distance. There is not a road in the country that is not making a good profit handling some kinds of business, while on another kind of business its rate is barely high enough to be remunerative and barely low enough to move the traffic; therefore, a horizontal reduction in rates is almost certain to make the rates on some business unremunerative and a horizontal advance to make it impossible for some goods to be shipped. The value of commodities, the distances they are to be hauled, the competition of carriers and markets and many other factors should be considered. Unfortunately there is hardly a State railroad commission that is not frequently or habitually violating every correct principle of rate-making. The results produced by the distance tariffs, the schedules discriminating in favor of local as against national interests and other obstacles that are being put in the way of the free movement of commerce will cause more and more trouble and loss to the railroads and to industry in general unless the powers of the commissions are narrowed or their mental vision is widened.

The amount of profit that railroads ought to be allowed to earn should be treated solely as a matter of expediency. The public will harm itself by exercising its legal right to reduce rates to the point where they are barely not confiscatory. Railroads compete in the money-market with manufacturing, mercantile and other concerns for capital. Capital is invested where, allowance being made for difference of risk, it can get the largest return. If railroads are restricted by reduction in rates, as some propose, to the current rate of interest on the bare value of their physical properties, while investors can get an average of from fifteen to twenty per cent. from investment in manufactures, is it probable that capital will be permanently forthcoming for the adequate maintenance and development of the country's rail transportation system?

The argument most commonly made for governmental regulation of the financial affairs of American railroads is that they are over-capitalized and charge excessive rates to pay dividends on their watered stocks. Over \$3,000,000,000 of railroad stocks and bonds are owned by the railroads of the United States themselves.

Allowing for this duplication, their average net capitalization in 1907 was less than \$58,000 per mile. The average capitalization of the railroads of Canada is almost \$56,000 per mile and of the railroads of Mexico is almost \$58,000 per mile. The cost of the German railroads has been \$105,000 per mile. The capitalization of the railroads of France is \$134,000 per mile; of those of the United Kingdom, \$272,000 per mile. There are some roads in this country that are over-capitalized and others that are under-capitalized, but a fair valuation would probably show that as a whole the railroads of the United States are worth more than they are capitalized for. It may be said, however, that regulation is needed at least to keep the roads that are over-capitalized from charging exorbitant rates. But the over-capitalized roads cannot charge excessive rates because they have to meet the rates of the roads that are fairly capitalized. A water-logged road like the Chicago Great Western has got to make the same rates as such competitors as the Chicago and Northwestern, the Chicago, Burlington and Quincy and the Chicago, Milwaukee and St. Paul or quit business. "The capitalization of the railroads, I think, cuts no figure in this rate question," Martin A. Knapp, chairman of the Interstate Commerce Commission, once said. The true justification of public regulation of railroad finances, if there be any good reason for it, is that it is needed to insure good transportation service and to protect investors.

There is always danger that an over-capitalized road, in order to keep up the price of its securities, will pay out in interest and dividends what ought to be spent on maintenance of the property.

The Interstate Commerce Commission, acting with authority given by the Hepburn act, required the railroads to begin the use, on July 1st, 1907, of a uniform system of accounting. In several States the same accounting system has been prescribed. The system may be defective in details, but it is a move in the right direction.

In order to prevent railroads from being loaded with debt, plunged into bankruptcy, and thereby rendered incapable of performing properly their duty to the public, public regulation should, perhaps, be exercised in future over their issues of bonds and other evidences of indebtedness. It ought to be seen that every bond issued has back of it a good deal more than an equivalent in tangible value. It ought, if practicable, to be seen that every

dollar raised by the sale of securities goes into the development and improvement of the property, and not into some pocket where it has no business. The looting of railroads should be guarded against and punished like the looting of banks. Whether any steps, except those necessary to accomplish these purposes, should be taken is extremely doubtful. A law of Massachusetts provided for fifteen years that securities might not be issued except at their market price; what the market price was, to be determined by the State railroad commission. Texas prohibits the issuance by any railroad of stocks and bonds having a par value more than fifty per cent. in excess of the value of its property as fixed by the State railroad commission; and the commission has fixed the "true value" of Texas roads at only forty-eight per cent. of their assessment by the State Tax Board, at fifty per cent. of their capitalization and at little less than the amount of their outstanding bonds, thereby making the issue of new securities practically impossible. Railroad officers of the highest reputation contend that the administration of these laws has hindered railroad development in both Massachusetts and Texas; and the legislature of Massachusetts in 1908 amended the law in that State so as to provide that the stockholders of transportation companies may fix the price at which stock shall be issued, and that the railroad commission may refuse its approval only if in its opinion "the price fixed by the stockholders is so low as to be inconsistent with the public interest." Congress and the legislatures of the States should not act until they are sure the laws regulating security issues that they shall pass will not so hamper legitimate business as to do more harm than good.

"Virtue," said Aristotle, "is a middle state between two faulty states, in the way of excess on one side and defect on the other; and it is so, moreover, because the faulty states on one side fall short of and those on the other side exceed what is right." To make Government regulation of railroads fair and successful, the faulty state on the side of the reactionary that would fall short of, and the faulty state on the side of the radical that would exceed, what is right, must equally be avoided. No right of the public should be left unprotected. At the same time no restriction or burden that the protection of the rights of the public does not clearly require should be placed upon the railroad.

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